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No. ——

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

GENERAL ELECTRIC CAPITAL CORPORATION,
Petitioner,

v.

NORTH COUNTY JEEP & RENAULT, INC.,
Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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PETITION FOR WRIT OF CERTIORARI

IRVING SULMEYER
Counsel of Record
LEWIS RAYMOND LANDAU
SUSAN FRANCES MOLEY
SULMEYER, KUPETZ, BAUMANN & ROTHMAN
A Professional Corporation
300 South Grand Avenue, 14th Floor
Los Angeles, California 90071
(213) 626-2311
Attorneys for Petitioner, General Electric Capital Corporation

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTIONS PRESENTED

1. Bankruptcy Code § 506(c) provides that a bankruptcy trustee or debtor in possession may recover from, or "surcharge," a secured creditor's collateral for the reasonable, necessary costs and expenses of preserving, or disposing of, such collateral to the extent of any benefit to the secured creditor. Did the Ninth Circuit err in extending standing to surcharge a secured creditor's collateral under 11 U.S.C. § 506(c) to third parties other than trustees and debtors in possession in contravention of the plain and unambiguous text of the statute and the statute's legislative history?

If the Court concludes that Section 506(c) standing is available to third parties, then the following additional question is presented for determination:

2. Did the Ninth Circuit err by failing to set forth the parameters for permitting third party standing under 11 U.S.C. § 506(c) upon which bankruptcy administrators and secured creditors can rely?

LIST OF PARTIES

The parties to the proceeding below were the Petitioner, General Electric Capital Corporation, and the Respondent, North County Jeep & Renault, Inc.

General Electric Capital Corporation is a corporation specializing in the making of commercial loans.*

North County Jeep & Renault, Inc. is a corporation organized under the laws of the State of California.

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* General Electric Capital Corporation is a wholly owned subsidiary of General Electric Financial Services, Inc., which in turn is a wholly owned subsidiary of General Electric Company. General Electric Capital Corporation has no non-wholly owned subsidiaries in the United States that have publicly traded shares or debt securities.

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PETITION FOR WRIT OF CERTIORARI

General Electric Capital Corporation, the Petitioner herein, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered in the above-entitled case on December 16, 1991.

OPINIONS BELOW

The December 16, 1991 opinion of the Court of Appeals for the Ninth Circuit reverses the judgments of the United States Bankruptcy Appellate Panel for the Ninth Circuit and the United States Bankruptcy Court for the Southern District of California. The Ninth Circuit opinion is reported at 951 F.2d 229 and reprinted as Appendix A to this petition, at 1a.

On July 23, 1990, the United States Bankruptcy Appellate Panel for the Ninth Circuit entered its opinion affirming the judgment of the United States Bankruptcy Court for the Southern District of California. The bankruptcy appellate panel opinion was appealed by the Respondent to the court of appeals. The bankruptcy appellate panel opinion is reported at 116 Bankr. 169 and reprinted as Appendix B to this petition, at 7a.

The order of the Bankruptcy Court for the Southern District of California ruling that Respondent lacked standing to recover its losses under Section 506(c), from which appeal was taken by the Respondent to the bankruptcy appellate panel, was not published. The bankruptcy court's order, entered March 13, 1989, is reprinted as Appendix C to this petition, at 17a.

The order of the United States Court of Appeals for the Ninth Circuit denying Petitioner's Amended Motion for Rehearing was not published. The Ninth Circuit's order, entered February 27, 1992, is reprinted as Appendix D to this petition at 19a.

The order of the United States Bankruptcy Appellate Panel for the Ninth Circuit denying Respondent's Motion for Rehearing was not published. The bankruptcy appellate panel's order, entered August 23, 1990, is reprinted as Appendix E to this petition, at 20a.

The order of the Bankruptcy Court for the Southern District of California denying Respondent's Motion for Reconsideration was not published. The bankruptcy court's order, entered March 13, 1989, is reprinted as Appendix F to this petition, at 21a.

JURISDICTION

The judgment of the Court of Appeals for the Ninth Circuit was entered on December 16, 1991, reversing the judgments in favor of the Petitioner entered by the United States Bankruptcy Appellate Panel for the Ninth Circuit

and the United States Bankruptcy Court for the Southern District of California. This Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTES INVOLVED

This case involves the issue of standing under § 506(c) of the Bankruptcy Code, Title 11 of the United States Code. Respondent, a third party, was granted standing by the United States Court of Appeals for the Ninth Circuit to surcharge Petitioner's collateral pursuant to section 506(c). Section 506(c) provides:

> *the trustee may* recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim. (emphasis added.)

By operation of § 1107(a) of the Bankruptcy Code, Title 11 of the United States Code, the debtor in possession is granted the rights, powers, and duties of a trustee, whereby the debtor in possession would have standing under 11 U.S.C. § 506(c) to surcharge a secured claimant's collateral. Section 1107(a) provides:

> Subject to any limitations on a trustee serving in a case under this chapter, and to such limitations or conditions as the court prescribes, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all the functions and duties, except the duties specified in sections 1106 (a)(2), (3), and (4) of this title, of a trustee serving in a case under this chapter.

STATEMENT OF THE CASE

This case involves an issue of grave importance to the administration of any bankruptcy case in which secured lenders and administrative claimants are involved.

Since virtually all of the 943,987[1] bankruptcy cases filed during 1991 involved at least one secured lender and one administrative claimant, the outcome of this case has a wide reaching impact.

The disputed issue in this case is the propriety of granting standing to third party administrative claimants to surcharge the collateral of secured lenders under 11 U.S.C. § 506(c). The Courts of Appeals in the First, Third, Fifth, and now Ninth Circuits, have erroneously granted standing to third parties under 11 U.S.C. § 506(c) in direct contravention of the "plain meaning" of the statute. The bases for granting standing to third parties under 11 U.S.C. § 506(c) by the four courts of appeals are conflicting. This Court must address and resolve this issue in accordance with the "plain meaning" rule of statutory construction in order to avoid the demise of the administration of hundreds of thousands of bankruptcy cases.

Palomar Truck Corporation ("Debtor") operated a motor vehicle dealership. The Debtor filed a voluntary petition under Chapter 11 of the United States Bankruptcy Code on March 28, 1988. Three months later, a Chapter 11 trustee ("Trustee") was appointed. The Trustee sought a purchaser for the Debtor's assets that were held subject to the security interests of General Motors Acceptance Corporation ("GMAC"), Chrysler Credit Corporation ("CCC") and several other parties, including General Electric Capital Corporation, Petitioner herein, which held a blanket security interest in all of the Debtor's assets subject only to the superior claims of GMAC and CCC.

In early June of 1988, the Trustee met with a representative of North County Jeep and Renault, Inc., Respondent herein. The Trustee and Respondent negotiated

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[1] Reprinted in Bankruptcy Court Decisions, Weekly News and Comment, Volume 22, Issue 28, April 16, 1992 from statistics compiled by the Administrative Office of the United States Courts, p. A6.

a $150,000.00 price for the sale of all of the Debtor's assets to Respondent, including its franchise rights. The Trustee and Respondent then entered into an operating agreement ("Operating Agreement"), which was not presented to the bankruptcy court, whereby Respondent agreed to operate the motor vehicle dealership at its own expense realizing any profits and bearing any losses therefrom, pending bankruptcy court approval of the purchase transaction. Respondent's assumption of any risk of loss was specifically set forth in paragraph 4 of the Operating Agreement which provided as follows:

> Any profits derived from the operation of Palomar Truck commencing June 10, 1988, shall belong to North County. Any losses of Palomar Truck relating to operations commencing June 10, 1988 shall be borne by North County.

When the purchase transaction was presented to the bankruptcy court for approval, the court determined that other bids would be accepted for the Debtor's assets, which resulted in a successful high bid of $495,000.00 by another party. Hence, Respondent relinquished operation of the dealership to the high bidder on July 6, 1988 and later moved for the allowance of $66,601.79 as an administrative expense attributable to the loss it incurred during its operation of the dealership. The bankruptcy court allowed the $66,601.79 loss as an administrative expense. However, there were no funds available in the estate to satisfy Respondent's administrative claim since all of the Debtor's assets were subject to the secured creditors' liens. Therefore, Respondent sought to have its administrative claim surcharged against Petitioner's collateral under 11 U.S.C. § 506(c).

Both the bankruptcy court and the bankruptcy appellate panel held that Respondent, who was neither the debtor nor the trustee in this case, did not have standing to surcharge Petitioner's collateral. The bankruptcy appellate panel then denied Respondent's Motion for Re-

hearing. However, the Court of Appeals for the Ninth Circuit, relying upon the decision of the Court of Appeals for the Third Circuit in *In re McKeesport Steel Castings Co.*, 799 F.2d 91 (3rd Cir. 1986), reversed the lower courts and held that Respondent had standing under 11 U.S.C. § 506(c) to surcharge Petitioner's collateral. The Ninth Circuit denied Petitioner's Motion for Reconsideration. Wherefore, Petitioner brings this petition for certiorari on an issue of first impression before this Court.

REASONS FOR GRANTING CERTIORARI

The issue of standing to surcharge the collateral of a secured creditor under 11 U.S.C. § 506(c) impacts virtually all of the bankruptcy cases filed in the United States each year due to the presence of administrative claimants and secured creditors in almost every case. The type of surcharging to which Petitioner objects occurs where parties who have provided goods or services to the trustee or debtor in possession become administrative claimants to a bankruptcy estate with no available funds or unencumbered assets. In an effort to collect their administrative claims, the third parties then seek recovery under 11 U.S.C. § 506(c) from the assets of the estate held subject to the liens of secured creditors. The result is that the secured creditors may be forced to defend a myriad of actions brought under 11 U.S.C. § 506(c) with no benefit to the estate because the recovery is remitted directly to the third party. Consequently, the amounts allowed to be surcharged against the secured creditors' collateral then become unsecured claims of the secured creditors against the estate. Effectively, the classification of claims is shifted with the total amount of claims remaining static. The final outcome of the successful third party 11 U.S.C. § 506(c) actions is that third party administrative claimants circumvent the priority scheme of the Bankruptcy Code by elevating the status of their claims from unsecured to superpriority or secured status.

Such chaos in the already overburdened bankruptcy court system can be avoided by a simple adherence to the "plain meaning" of the statute, which explicitly states that "the trustee may" [2] with no reference to third party standing. The holdings of the First, Third, Fifth and Ninth Circuit Courts of Appeals permitting third party standing under 11 U.S.C. § 506(c) are in contravention of this Court's holding in *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989) that "[t]he plain meaning of legislation should be conclusive, except in the 'rare cases' [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters." *Id.* at 242, *citing Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982). Moreover, the bases upon which the courts of appeals in four circuits have granted third party standing under 11 U.S.C. § 506(c) are conflicting. Thus, there is no predictable standard upon which secured lenders may rely for the uniform treatment of their collateral under Federal Bankruptcy Laws, even within the circuits that have violated the "plain meaning" rule in construing the statute. Finally, the issue presented in this case has such a wide reaching impact upon the administration of bankruptcy cases and the dockets of the bankruptcy court system that certiorari should be granted in accordance with *Reading Company v. Francis Shunk Brown*, 391 U.S. 471 (1968), wherein this Court granted certiorari due to the importance of the issue to the administration of the bankruptcy laws and one of first impression in the Supreme Court. *See also City of New York v. Saper*, 336 U.S. 328 (1949).

I. THE DECISION OF THE NINTH CIRCUIT COURT OF APPEALS IN THE INSTANT CASE VIOLATES THE "PLAIN MEANING" RULE OF STATUTORY CONSTRUCTION

The First, Third, Fifth and, in the instant case, Ninth Circuit Courts of Appeals have recently granted third

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[2] And through the operation of 11 U.S.C. § 1107(a), "the debtor in possession may."

parties standing to surcharge the collateral of secured creditors under 11 U.S.C. § 506(c) in the cases of *In re Parque Forestal, Inc.*, 949 F.2d 504 (1st Cir. 1991), *In re McKeesport Steel Castings Co.*, 799 F.2d 91 (3rd Cir. 1986), *Matter of Delta Tower, Ltd.*, 924 F.2d 74 (5th Cir. 1991) and *In re Palomar Truck Corp.*, 951 F.2d 229 (9th Cir. 1991).[3]

The decision of the Ninth Circuit in the instant case and its three sister circuits ignore this Court's repeated

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[3] Despite the apparent uniformly erroneous granting of third party standing at the appellate level, numerous bankruptcy courts have reached a contrary conclusion on the issue of whether a party, other than the trustee or debtor in possession, has standing under 11 U.S.C. § 506(c). Those courts which have adhered to a strict interpretation of 11 U.S.C. § 506(c) and denied such standing include: *Matter of Great Northern Forest Products, Inc.*, 135 Bankr. 46 (Bankr. W.D. Mich. 1991); *White Front Feed & Seed, Inc. v. State Nat'l Bank of Plattenville (In re Ramaker)*, 117 Bankr. 959 (Bankr. N.D. Iowa 1990); *Central States, Southeast and Southwest Areas Pension Fund v. Robbins (In re Interstate Motor Freight Sys., IMFS, Inc.)*, 86 Bankr. 500 (Bankr. W.D. Mich. 1988); *Central States, Southeast and Southwest Areas Pension Fund v. Robbins (In re Interstate Motor Freight Sys., IMFS, Inc.)*, 71 Bankr. 741 (Bankr. W.D. Mich. 1987); *In re Dakota Lay'd Eggs*, 68 Bankr. 975 (Bankr. D.N.D. 1987); *In re Wyckoff*, 52 Bankr. 164 (Bankr. W.D. Mich. 1985); *In re Fabian*, 46 Bankr. 139 (Bankr. E.D. Pa. 1985); *In re Proto-Specialties, Inc.*, 43 Bankr. 81 (Bankr. D. Ariz. 1984); *In re Codesco, Inc.*, 18 Bankr. 225 (Bankr. S.D.N.Y. 1982).

The courts which have refused to adhere to the "plain meaning" rule of statutory construction include: *In re Brown Brothers, Inc.*, 136 Bankr. 470 (W.D. Mich. 1991); *In re Evanston Beauty Supply, Inc.*, 136 Bankr. 171 (Bankr. N.D. Ill. 1992); *Matter of Saybrook Mfg. Co., Inc.*, 130 Bankr. 1013 (Bankr. M.D. Ga. 1991); *In re Scopetta-Senra Partnership III*, 129 Bankr. 700 (Bankr. S.D. Fla. 1991); *In re Mechanical Maintenance*, 128 Bankr. 382 (E.D. Pa. 1991); *Cavender v. Ameritrust Co., N.A. (In re Opti-Gage)*, 124 Bankr. 515 (Bankr. S.D. Ohio 1991); *In re So Good South Potato Chip Co.*, 116 Bankr. 144 (Bankr. E.D. Mo. 1990); *Geller v. Int'l Club Enter., Inc. (In re Int'l Club Enter., Inc.)* 105 Bankr. 190 (Bankr. D.R.I. 1989); *In re World Wines, Ltd.*, 77 Bankr. 653 (Bankr. N.D. Ill. 1987); *Guy v. Grogan (In re Staunton Indus., Inc.)*, 74 Bankr. 501 (Bankr. E.D. Mich. 1987); *In re T.P. Long Chemical, Inc.*, 45 Bankr. 278 (Bankr. N.D. Ohio 1985).

admonition that when construing the provisions of the Bankruptcy Code, as with other statutes, "[t]he plain meaning of the legislation should be conclusive, except in the 'rare cases' [in which] the literal application of a statute will produce a result *demonstrably* at odds with the intentions of its drafters." *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242 (1989) (emphasis added, citation omitted). *See e.g., Taylor v. Freeland & Kronz*, No. 91-571, at 4-5 (April 21, 1992) (declining to depart from literal interpretation of 11 U.S.C. § 522(1) and Bankruptcy Rule 4003); *Barnhill v. Johnson*, 112 S. Ct. 1386, 1391 (1992) ("appeals to statutory history are well-taken only to resolve 'statutory ambiguity' "); *Union Bank v. Wolas*, 112 S. Ct. 527, 530 (1991) (declining to deviate from the literal terms of section 547(c)(2) and stating that the burden of persuading the Court that Congress had a contrary intent is "exceptionally heavy"); *Toibb v. Radloff*, 111 S. Ct. 2197, 2199 (1991) (concluding that "the plain language of the Bankruptcy Code" disposes of the question of whether an individual debtor may seek the protections of Chapter 11). *See also Connecticut Nat'l Bank v. Germain*, 112 S. Ct. 1146, 1149 (1992) ("[W]e have stated time and again that courts must presume that a legislature says in a statute what it means and means in a statute what it says there").

The statute is utterly devoid of language that could lead a court to conclude that Congress intended third parties to have standing under 11 U.S.C. § 506(c). The statute specifically states "the trustee may. . . ."[4] The statute is plain and unambiguous on its face and the courts should have looked no further than its express language. Notwithstanding the fact that a determination of congressional intent in interpreting 11 U.S.C. § 506(c) is unnecessary, an examination of the drafter's intention reveals a record devoid of any reference to third party

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[4] *See* foonote 2, *supra*.

standing. The legislative history of 11 U.S.C. § 506(c) states:

> Any time the *trustee or debtor in possession* expends money to provide for the reasonable and necessary costs and expenses of preserving or disposing of a secured creditor's collateral, the *trustee or debtor in possession* is entitled to recover such expenses from the secured party or from the property securing an allowed secured claim held by such party.

124 Cong. Rec. H11,085 (daily ed. Sept. 28, 1978) (statement of Rep. Edwards) (emphasis added).

Hence, as a matter of statutory construction, 11 U.S.C. § 506(c) is plain and unambiguous on its face and even an unnecessary review of the legislative history surrounding its enactment reveals that congressional intent was only to provide for standing by a trustee or debtor in possession to surcharge a secured claimant's collateral under 11 U.S.C. § 506(c).

Finally, courts that have strayed from a strict adherence to the "plain meaning" of 11 U.S.C. § 506(c) have justified their holdings based upon alleged inequities that might result from denying standing to third parties. However, that justification is in violation of this Court's mandate that a bankruptcy court may not use equitable principles to disregard unambiguous statutory language. *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206-7 (1988); *Ray v. City Bank & Trust Co. (In re C-L Cartage Co., Inc.)*, 899 F.2d 1490, 1494 (6th Cir. 1990). In reality, no inequity results from refusing to grant third party standing under 11 U.S.C. § 506(c) because third parties can protect themselves when they provide post-petition services to a trustee or debtor in possession through 11 U.S.C. § 364. Permitting third party standing under 11 U.S.C. § 506(c) allows third parties to circumvent a risk they knowingly assumed.

II. THE DECISION OF THE CIRCUIT WHICH INITIALLY GRANTED THIRD PARTY STANDING WAS WRONGLY DECIDED AND THE THREE OTHER CIRCUITS WHICH HAVE FOLLOWED THAT DECISION HAVE DONE SO ON CONFLICTING BASES

The first court of appeals to grant third party standing under 11 U.S.C. § 506(c) was the Third Circuit in *In re McKeesport Steel Castings Co.*, 799 F.2d 91 (3rd Cir. 1986). The court in *McKeesport* based its decision to grant third party standing on the decisions of four lower courts in *In re Philadelphia Light Supply Co.*, 39 Bankr. 51 (Bankr. E.D. Pa. 1984), *In re Monsour Medical Center*, 5 Bankr. 715 (Bankr. W.D. Pa. 1980), *In re T.P. Long Chemical, Inc.*, 45 Bankr. 278 (Bankr. N.D. Ohio 1985) and *In re Isaac Cohen Clothing Corp.*, 39 Bankr. 199 (Bankr. S.D.N.Y. 1984). A review of those four decisions demonstrates that the Third Circuit's ruling was unsupported by any applicable precedent.

The courts in *Philadelphia Light Supply* and *Monsour Medical Center* granted third parties standing to pursue preference actions under 11 U.S.C. § 547 on behalf of the estate. The third party standing in *Philadelphia Light Supply* and *Monsour Medical Center* is derivative standing where a party, other than the trustee or debtor in possession, brings an action on behalf of the estate for the benefit of the estate. Bankruptcy courts evaluate whether to grant derivative standing on behalf of the estate based upon (1) whether the party seeking standing has a colorable claim and (2) whether the party seeking standing is the only party who will pursue the claim. Any recovery under derivative standing would be remitted directly to the estate for potential distribution to all parties in interest to the estate. Whereas, an action under 11 U.S.C. § 506(c) is brought by an administrative claimant on its own behalf with no benefit to the estate whatsoever unless it is the trustee or the debtor in possession bringing the action. Any recovery by a third party administrative claimant would bypass the estate and go directly into the claimant's pocket.

> Cases [including *Philadelphia Light Supply* and *Monsour Medical Center*] that allow an entity to be substituted for the trustee [or debtor in possession] as a plaintiff should not be interpreted to create independent direct standing for a creditor to assert a cause of action for its sole individual benefit.

Matter of Great Northern Forest Products, Inc., 135 Bankr. 46, 68 (Bankr. W.D. Mich. 1991). Hence, the reliance on *Philadelphia Light Supply* and *Monsour Medical Center* by the Third Circuit to grant third party standing under 11 U.S.C. § 506(c) was erroneous.

The case of *T.P. Long Chemical* involved the Environmental Protection Agency ("EPA") seeking to be reimbursed by a secured creditor for costs incurred in removing hazardous chemicals from the estate's property. The court, *in dicta*, granted the EPA standing to bring an action under 11 U.S.C. § 506(c) because it had "discharged a duty of the trustee", *In re T.P. Long Chemical, Inc.*, 45 Bankr. 278, 287. However, the court denied the EPA recovery since there was no showing that the secured creditor's collateral was benefited. The benefit derived from the EPA's actions was to the estate and the general public. The basis for the court in *T.P. Long Chemical, Inc.* to grant standing to the EPA was derivative standing thorugh its discharging the duty of the trustee. The Third Circuit's reliance upon dicta in *T.P. Long Chemical, Inc.* to grant third party standing under 11 U.S.C. § 506(c) was erroneous where the court below had found an action under 11 U.S.C. § 506(c) could not be sustained.

The court in *Isaac* permitted a landlord to recover under 11 U.S.C. § 506(c) the costs for storage of the secured lender's collateral. The *Isaac* court, in permitting the landlord to recover under 11 U.S.C. § 506(c), made absolutely no comment regarding standing. Furthermore, it essentially failed to apply the judicially created test for application of 11 U.S.C. § 506(c), which is a two prong

process: (1) does the party asserting an action have standing?; and (2) was the expenditure necessary, the amount reasonable, and did it primarily and directly benefit the secured creditor's collateral? Hence, the Third Circuit's reliance upon *Isaac* to grant third party standing under 11 U.S.C. § 506(c) was erroneous where the *Isaac* court never addressed the issue of standing and failed to apply the proper two prong test for application of the statute.

Moreover, although the First, Fifth and Ninth Circuits claim to have relied upon the wrongly-decided *McKeesport* decision to grant third party standing under 11 U.S.C. § 506(c), the bases upon which the four circuits have granted third party standing are conflicting, leaving no predictable standard upon which secured lenders may rely for the uniform treatment of their collateral under the Federal Bankruptcy Laws. The factors upon which the First and Third Circuits permit third party standing are those from the derivative standing cases: (1) whether the trustee or debtor in possession has any real incentive to pursue the claim and (2) whether the creditor has a colorable claim. *See In re Parque Forestal, Inc.*, 949 F.2d at 512 and *In re McKeesport Steel Castings Co.*, 799 F.2d at 94. The factor upon which the Fifth Circuit permits third party standing is whether the trustee or debtor in possession has refused to pursue such a claim. *See Matter of Delta Towers, Ltd.*, 924 F.2d at 77. In the instant case, the factor upon which the Ninth Circuit granted third party standing was whether the trustee or debtor in possession had an economic interest to pursue recovery under 11 U.S.C. § 506(c). *See In re Palomar Truck Corp.*, 951 F.2d at 232.[5] This court should resolve these conflicting

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[5] For further analysis of the conflicting bases upon which third party standing has been granted under 11 U.S.C. § 506(c), *See* address by Elizabeth J. Futrell, *Parque Forestal—How Much Stand-*

bases upon which third party standing is granted by requiring lower courts to adhere to the "plain meaning" rule of statutory construction in interpreting 11 U.S.C. § 506(c).

III. THE IMPACT OF PERMITTING THIRD PARTY STANDING UNDER 11 U.S.C. 506(c) IS CHAOS IN THE ADMINISTRATION OF BANKRUPTCY CASES AND THE DOCKETS OF THE BANKRUPTCY COURT SYSTEM

In addition to the absurd result in *Palomar*, where Respondent was permitted to surcharge Petitioner's collateral despite having previously entered into an Operating Agreement wherein Respondent had expressly agreed to bear any risk of loss, the chaos inherent in granting third parties standing to surcharge collateral is amply demonstrated by the following: in *In re Mechanical Maintenance, Inc.*, 128 Bankr. 382 (E.D. Pa. 1991), the case was remanded to determine whether unpaid fringe benefits for union members incurred in the creation of postpetition accounts receivable (not yet collected) were reasonable, necessary, and directly beneficial to the secured lender so as to give the union members a superpriority in surcharging the secured creditor's collateral for payment of the union contributions; in *Fulcrum Int'l Ltd. v. Saybrook Mfg. Co.*, 124 Bankr. 141 (M.D. Ga. 1991), *aff'd on remand, Matter of Saybrook Mfg. Co., Inc.*, 130 Bankr. 1013 (Bankr. M.D. Ga. 1991), a broker who arranged for the sale of the debtor's assets, but who failed to apply for court approval of postpetition services rendered until ten months after Manufacturers Hanover had been granted a superpriority over all postpetition administrative expenses to secure its postpetition lending, was permitted to surcharge Manufacturers Hanover's collateral for a broker fee in arranging the sale;

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ing Room is Left in the Trustee's Section 506(c) Shoes?, presented before the ABA Spring meeting, Commercial Financial Services Creditors' Rights Subcommittee (April 10, 1992).

and in *In re Int'l Club Enter., Inc.*, 105 Bankr. 190 (Bankr. D.R.I. 1989), a secured claimant's collateral was surcharged for storage in lessor's nightclub premises after the trustee had abandoned the collateral.

In addition to being untenable, the results in the cases cited above, as in all cases permitting third party standing under 11 U.S.C. § 506(c), violate a fundamental policy of the Bankruptcy Code embodied in both 11 U.S.C. § 726 and 11 U.S.C. § 1123(a)(4) that similarly situated creditors must share pro rata in distributions from the estate.

> We have often declared that the pro-rata distribution of the property of the bankrupt was the main purpose of the bankruptcy statute. . . . A serious defect in that statute would be developed if its provisions received such a construction as would enable [administrative claimants] to defeat that purpose by obtaining an advantage over other creditors. We are of the opinion that no such construction is demanded either by [the bankruptcy statute's] letter or its spirit.

Reed v. McIntyre, 98 U.S. 507, 512, 25 L. Ed. 171 (1878) (citation omitted). *Accord, United States v. Embassy Restaurant, Inc.*, 359 U.S. 29, 31, 79 S. Ct. 554, 555, 3 L. Ed. 2d 601 (1959); *Nathanson v. NLRB*, 344 U.S. 25, 29, 73 S. Ct. 80, 83, 97 L. Ed. 23 (1952); *Young v. Higbee Co.*, 324 U.S. 204, 210, 65 S. Ct. 594, 597, 89 L. Ed. 890 (1945); *Sampsell v. Imperial Paper & Color Co.*, 313 U.S. 215, 219, 61 S. Ct. 904, 907, 85 L. Ed. 1293 (1941); *Kothe v. R.C. Taylor Trust*, 280 U.S. 224, 227, 50 S. Ct. 142, 143, 74 L. Ed. 382 (1930); *Acme Harvester Co. v. Beekman Lumber Co.*, 222 U.S. 300, 307, 32 S. Ct. 96, 99, 56 L. Ed. 208 (1911); *First Nat'l Bank of Baltimore v. Staake*, 202 U.S. 141, 148, 26 S. Ct. 580, 583, 50 L. Ed. 967 (1906); *Boese v. King*, 108 U.S. 379, 385-86, 2 S. Ct. 765, 769-70, 27 L. Ed. 760 (1883); *Wukelic v. United States*, 544 F.2d

> 285, 289 (6th Cir. 1976); *In re Kohler*, 159 F. 871, 873-74 (6th Cir. 1908); *Lasich v. Estate of A.N. Wickstrom (Matter of Wickstrom)*, 113 Bankr. 339, 348 (Bankr. W.D. Mich. 1990). An axiom of the Bankruptcy Code is equality of distribution; therefore, 'if one claimant is to be preferred over others, the purpose should be *clear* from the statute.' *Nathanson*, 334 U.S. at 29, 73 S. Ct. at 83 (emphasis added).

Matter of Great Northern Forest Products, Inc., 135 Bankr. at 66, in a decision holding that third party standing is not permissible under 11 U.S.C. § 506(c).

When a third party administrative claimant is permitted to surcharge a secured creditor's collateral, he is elevated from the status of a general administrative claimant to a superpriority administrative claimant. The effect of the violation on the equality of distribution policy is exaggerated to the point of elevating an administrative claimant to the status of a secured creditor in an estate where all of the estate's assets are subject to the liens of secured creditors. Such a result violates the fundamental policy of equality of distribution to similarly situated creditors and should not be allowed.

A fundamental element to the success of a Chapter 11 case is that creditors are encouraged to cooperate with the debtor in possession or Chapter 11 trustee in its efforts to reorganize the estate. Secured lenders are familiar with the Bankruptcy Code, thus, when extending credit, factor into their lending the risk that a trustee or debtor in possession may surcharge their collateral. However, when a third party is granted standing under 11 U.S.C. § 506(c), it presents a situation that the lender did not anticipate or bargain for in its financing transactions. Permitting third party standing under 11 U.S.C. § 506(c) discourages secured lenders from extending post-petition financing for fear that unanticipated parties may be granted superpriority status over their liens. Indeed, third party standing under 11 U.S.C. § 506(c)

discourages creditors from cooperating in any manner with debtors and encourages them to immediately and vigorously seek to take back their collateral so as to avoid having it surcharged by third party administrative claimants. Hence, the ultimate effect of the erroneous decisions by the four circuit courts of appeals may be to impede the success of Chapter 11 cases and make collateralized borrowing more expensive in and outside of bankruptcy.

Moreover, permitting third party standing under 11 U.S.C. § 506(c) may result in a post-administration race to the courthouse because "any recovery of costs [under 11 U.S.C. § 506(c)] is limited to the extent of the benefit conferred on the secured creditor." H.R. Rep. 595, 95th Cong., 1st Sess. 357 (1977); S. Rep. No. 989, 95th Cong., 2d Sess. 68 (1978); *reprinted* in 1978 U.S. Code Cong. & Admin. News 5787, 5854, 6313. Since all parties seeking to recover under 11 U.S.C. § 506(c) are limited to the benefit conferred on the secured creditor, regardless of the amounts expended, those who collect first will likely exhaust the amount a secured creditor has been benefited. The situation that may result from this post-administration race to the courthouse is illustrated in a discussion of the Bankruptcy Code vesting the powers of avoidance only in the trustee or debtor in possession in the case of *Matter of Pointer*, 952 F.2d 82 (5th Cir. 1992).

> If creditors . . . were answerable to other creditors in the case, so that . . . creditors might shoot it out while the debtor stood by passively without having a choice in the matter, the net result would be the demise of the case.

Id. at 87-88 *citing In re Ciavarella*, 28 Bankr. 823, 825 (Bankr. S.D.N.Y. 1983).

Finally, permitting third party standing under 11 U.S.C. § 506(c) and all of the adverse consequences resulting therefrom, is unnecessary since a third party administrative claimant has alternative remedies where

the trustee or debtor in possession fails to comply with its duties in preserving, or disposing of, a secured creditor's collateral such as

> (1) requesting the court to compel the trustee or debtor in possession to seek a surcharge; (2) requesting the court to remove the trustee; (3) if a debtor in possession is managing the estate, requesting the court to appoint a trustee; (4) procuring an administrative priority under § 503(b); (5) seeking court approved derivative standing to pursue the action, on behalf of the trustee, for the benefit of the estate. Also, under appropriate circumstances, a creditor may conceivably be entitled to sue a secured creditor outside of the bankruptcy court pursuant to a state law cause of action.

Matter of Great Northern Forest Products Inc., 135 Bankr. at 69, n.28. Moreover, 11 U.S.C. § 364(d) provides a mechanism for unsecured credit extended to the estate to obtain a senior lien on property of the estate, after notice to the affected secured creditor.

IV. IF THIS COURT DETERMINES THAT THIRD PARTY STANDING UNDER 11 U.S.C. § 506(c) IS APPROPRIATE UNDER CERTAIN CIRCUMSTANCES, THEN LEGAL STANDARDS MUST BE ESTABLISHED AS TO WHAT CONSTITUTES APPROPRIATE CIRCUMSTANCES AND TO WHOM SURCHARGE RECOVERIES SHOULD BE PAID

If the court concludes that the Ninth Circuit's "breach under appropriate circumstances" ruling is proper, then it is nevertheless appropriate for this Court to grant this petition so as to clarify four issues that remain clouded in the decision's wake.

First, the Ninth Circuit stated that no compelling policies are served by a restrictive reading of 11 U.S.C. § 506(c) in the circumstances of this particular case. Petitioner believes that if any case requires a restrictive reading of 11 U.S.C. § 506(c), it is the case at bar. In this case, Respondent entered into a contract with the

bankruptcy trustee *that shifted the risk of loss to Respondent.* Unlike *McKeesport*, where the bankruptcy court ordered that utility service be sustained, Respondent herein specifically took the risk of loss upon itself. Thus, clarification of the circumstances requiring an expanded reading of standing under 11 U.S.C. § 506(c) is required.

Second, the Ninth Circuit opinion implies that recovery would pass to the claimant directly with no benefit to the estate. If this result is correct, federal court jurisdiction over the surcharge action is lost. In order to avoid jurisdictional questions, recoveries under 11 U.S.C. § 506(c) must be remitted to the estate.

Third, the Ninth Circuit purposefully did not address "whether a third party claimant should have standing only in those cases where the trustee or debtor in possession has refused a third party's request to recover the property." *In re Palomar Truck Corp.*, 951 F.2d at 232. The failure of the Ninth Circuit to decide this issue, as compared with the Fifth Circuit which apparently requires demand on the trustee or debtor in possession, leaves the state of the law in flux.

Fourth, the term "the trustee may" should be uniformly interpreted throughout the Bankruptcy Code. The Ninth Circuit's interpretation conflicts with that of the Fifth Circuit in *Matter of Pointer*, 952 F.2d at 88, which followed the plain meaning rule in interpreting the term "the trustee may" in Bankruptcy Code § 549. Thus, clarification of the proper interpretation of 11 U.S.C. § 506(c) is required to avoid the effect of the Ninth Circuit's decision upon other Code sections. Since the plain and unambiguous text of the statute would no longer set forth the statute's "plain meaning," all parties engaged in the administration of bankruptcy cases are left in a state of confusion regarding this decision's impact on the other Code sections that provide that "the trustee may." [6]

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[6] *See e.g.*: 11 U.S.C. § 327—"the trustee may employ"; 11 U.S.C. § 363(b)—"the trustee . . . may use, sell or lease"; 11 U.S.C. § 364—"the trustee may obtain unsecured credit"; 11 U.S.C. § 365—"the

CONCLUSION

WHEREFORE, Petitioner, General Electric Capital Corporation, prays that a writ of certiorari issue from This Honorable Court to review the judgment of the Court of Appeals for the Ninth Circuit in *North County Jeep & Renault, Inc. v. General Electric Capital Corporation (In re Palomar Truck Corp.)*. In the event that the petition is granted, Petitioner prays that the judgment of the Court of Appeals for the Ninth Circuit be reversed and that a mandate issue dismissing the action of *North County Jeep & Renault, Inc. v. General Electric Capital Corporation (In re Palomar Truck Corp.)* for lack of standing.

Respectfully submitted,

IRVING SULMEYER
Counsel of Record
LEWIS RAYMOND LANDAU
SUSAN FRANCES MOLEY
SULMEYER, KUPETZ, BAUMANN
& ROTHMAN
A Professional Corporation
300 South Grand Avenue, 14th Floor
Los Angeles, California 90071
(213) 626-2311
Attorneys for Petitioner,
General Electric Capital
Corporation

Dated: May —, 1992

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trustee . . . may assume"; 11 U.S.C. § 544—"the trustee may avoid"; 11 U.S.C. § 545—"the trustee may avoid"; 11 U.S.C. § 547—"the trustee may avoid"; 11 U.S.C. § 548—"the trustee may avoid"; 11 U.S.C. § 549—"the trustee may avoid"; 11 U.S.C. § 550 . . . "the trustee may recover."

APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
NINTH CIRCUIT

No. 90-56112

IN RE PALOMAR TRUCK CORPORATION, dba PALOMAR, R.V.,
Debtor.

NORTH COUNTY JEEP AND RENAULT, INC.,
Appellant,

v.

GENERAL ELECTRIC CAPITAL CORPORATION,
Appellee.

Appeal from the Ninth Circuit
Bankruptcy Appellate Panel

Submitted Oct. 8, 1991*

Decided Dec. 16, 1991

Alan L. Williams, San Diego, Cal., for appellant.

Gregory B. Beam and Sam M. Muriella, Hart, King and Coldren, Santa Ana, Cal., for appellee.

Before BROWNING, ALARCON and T.G. NELSON, Circuit Judges.

PER CURIAM:

Palomar Truck Corporation, which operated a motor vehicle dealership, filed a voluntary Chapter 11 petition. A trustee was appointed. The Trustee met with a repre-

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* The panel finds this case appropriate for submission without oral argument pursuant to Ninth Circuit Rule 34-4 and Fed.R.App. P. 34(a).

sentative of North County Jeep and Renault, Inc. ("North County"), and agreed to sell the dealership to North County for $150,000. The trustee and North County agreed the dealership must remain open to preserve the new car franchises pending court approval of the sale. Palomar lacked the money to continue operating the business. North County agreed to operate the dealership while the Trustee obtained court approval of the sale. In return, the Trustee promised that the sale would not be subject to overbid.

The bankruptcy court decided to entertain overbids despite the trustee's agreement to the contrary. The successful bidder, Sunroad Capital Corp., bid $495,000, and assumed operating responsibility for the dealership.

It is not disputed that if North County had not intervened the business would have closed, the franchise agreements would have been terminated and "presumably the value of the business would have been significantly reduced." *In re Palomar Truck Corp.*, 116 B.R. 169, 171 (Bankr. 9th Cir. 1990).

North County petitioned the bankruptcy court to allow $66,601.79, North County's loss during the period of interim operation of the dealership, as an administrative expense and to pay this expense from properties securing the claim of General Electric Capital Corporation (GECC),[1] pursuant to 11 U.S.C. § 506(c). The motion to allow the claim as an administrative expense was granted. The motion to order payment from property securing GECC's claim was denied on the ground North County lacked standing to assert a right for repayment under § 506(c). The Bankruptcy Appellate Panel af-

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[1] The new car inventory and assets of the dealership were subject to security interests in favor of General Motor Acceptance Corp. (GMAC) and Chrysler Credit Corp. (CCC). General Electric Capital Corp. (GECC), holds a blanket security interest in all Palomar assets, subject only to the superior claims of GMAC and CCC.

firmed, agreeing that North County lacked standing. *Palomar*, 116 B.R. at 174.[2]

Section 506(c) provides:

> The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim.

The legislative history extends standing to assert a claim under § 506(c) to debtors in possession as well as trustees. 124 Cong. Rec. H11095 (daily ed. Sept. 28, 1978) (statement of Rep. Edwards); S17411 (daily ed. Oct. 6, 1978) (statement of Sen. DeConcini). *See also* 11 U.S.C. § 1107(a) providing that in a proceeding under Chapter 11, a debtor in possession shall have the rights and powers of a trustee.

Bankruptcy court decisions are divided as to whether § 506(c) may also be invoked by third party claimants. Some bankruptcy courts have adopted a strict view, holding the section available only to trustees and debtors in possession.[3] Others have adopted a more expansive

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[2] North County argued, alternatively, the court should order payment of the operating loss under its equitable powers to subordinate claims under § 510(c), citing *In re Loop Hospital Partnership*, 50 B.R. 565 (Bankr.N.D.Ill.1985). North County has not demonstrated that GECC engaged in inequitable conduct, a prerequisite to equitable subordination under § 510(c). *In re Universal Farming Industries*, 873 F.2d 1334, 1337 (9th Cir.1989). The *Loop* court did not rely on the power of equitable subordination granted by § 510(c), but upon the general equitable power of bankruptcy courts. *Loop*, 50 B.R. at 571. As the BAP noted, there is insufficient evidence in the record to justify a grant of relief under the bankruptcy court's general equitable power on the basis of the factors noted in *Loop*, 50 B.R. at 571 n.*. *Palomar*, 116 B.R. at 173-74.

[3] See e.g., *In re Interstate Motor Freight Sys. IMFS, Inc.*, 71 B.R. 741, 746 (Bankr.W.D.Mich.1987); *In re Dakota Lay'd Eggs*, 68 B.R. 975, 978 (Bankr.D.N.D.1987); *In re Groves Farms, Inc.*, 64 B.R. 276, 277 (Bankr.S.D.Ind.1986); *In re Fabian*, 46 B.R. 139, 141

reading, extending standing to third parties.[4] A number of bankruptcy courts have adopted the expansive reading only upon a showing that the Trustee refused a request by the claimant to pursue the claim.[5]

The Court of Appeals for the Third Circuit addressed the issue *In re McKeesport Steel Castings Co.*, 799 F.2d 91 (3d Cir. 1986). In order to permit sale of the debtor's manufacturing company as a going business, the bankruptcy court ordered the gas company to continue to render service to the debtor and the gas company did so. The gas company later petitioned to recover the cost of the gas provided post-petition pursuant to the court's order. The Third Circuit held the gas company had standing under § 506(c) despite the seemingly categorical statutory language confining the remedy to trustees:

> The rule that individual creditors cannot act in lieu of the trustee is often breached when sufficient reason exists to permit the breach. In this case, neither the debtor in possession nor a creditors committee had reason to make a claim on behalf of [the gas company], when the debtor thereby would be required to pay for utilities it had received without charge following the date that its petition was filed. Thus, because [the gas company] had a colorable

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(Bankr.E.D.Pa.1985); *In re Thomas*, 43 B.R. 201, 208 (Bankr.M.D. Ga.1984); *In re Codesco, Inc.*, 18 B.R. 225, 230 (Bankr.S.D.N.Y. 1982).

[4] *See e.g., In re World Wines, Ltd.*, 77 B.R. 653, 658 (Bankr.N.D. Ill.1987); *In re Birdsboro Casting Corp.*, 69 B.R. 955, 958 (Bankr. E.D.Pa.1987); *In re Wyckoff*, 52 B.R. 164, 167 (Bankr.W.D.Mich. 1985) (dicta); *In re Loop Hospital Partnership*, 50 B.R. 565, 571 (Bankr.N.D.Ill.1985); *In re Isaac Cohen Clothing Corp.*, 39 B.R. 199, 201 (Bankr.S.D.N.Y.1984).

[5] *See, e.g., In re So Good South Potato Chip Co.*, 116 B.R. 144, 146 (Bankr.E.D.Mo.1990); *In re Staunton Industries, Inc.*, 74 B.R. 501, 506 (Bankr.E.D.Mich.1987); *In re DLS Industries, Inc.*, 71 B.R. 679, 681 (Bankr.D.Minn.1987). The record on appeal does not indicate whether such a demand was made by North County.

> claim for expenses and was the only creditor that would zealously pursue that claim, it has standing to bring a § 506(c) action.

Id. at 94.

The BAP distinguished *McKeesport* on two grounds. The BAP noted that in *McKeesport* the bankruptcy court was significantly involved in and had approved the arrangement that caused the administrative expense claim to accrue. In this case, there was no such involvement or approval. 116 B.R. at 173. In *McKeesport* the claim accrued during the continuation after bankruptcy of a pre-existing business relationship with the debtor. In this case, the claimant had no connection with the debtor prior to entering into the operating agreement, and "by entering into the agreement, embarked voluntarily on a new venture which it knew could result in either gain or loss." *Id.* GECC makes a similar point, arguing North County undertook to operate the dealership in order to acquire the business at a "bargain basement price."

These distinctions are not persuasive. Prior court approval may make a claim for administrative expenses more palatable, but it is nowhere required in the Code. Both the prior relationship between the debtor and the claimant and the motivation of the claimant seem irrelevant. Presumably all persons who provide services to Chapter 11 debtors do so for profit. The Code does not require that the claimant have the best interests of the secured creditors in mind, but only that the expenditures be "reasonable, necessary costs and expenses of preserving, or disposing of, such [secured] property." 11 U.S.C. § 506(c).

Like the trustee in *McKeesport*, the trustee here had no economic incentive to seek recovery under § 506(c), since the recovery would pass to the claimant with no gain to the estate. As in *McKeesport*, if only the trustee were allowed standing, the result would be a windfall for the secured creditor at the expense of the unpaid

claimant. 3 *Collier on Bankruptcy*, ¶ 506.06, at 506-57 to 506-58 n. 7a (15th ed. 1990).

No compelling policies are served by a restrictive reading of § 506(c) in the circumstances of this case. GECC argues that restricting standing to the trustee enables the trustee to maintain control of the liquidation of an estate, citing *In re Dakota Lay'd Eggs*, 68 B.R. 975, 978 (Bankr.D.N.D.1987), but this case involves a reorganization under Chapter 11, not a liquidation. GECC cites *In re Interstate Motor Freight System IMFS, Inc.*, 71 B.R. 741, 744 (Bankr.W.D.Mich.1987), in support of the contention that a narrow reading preserves Section 726's policy favoring parity of payment to all claimants in a class. Again, this policy is not applicable in the Chapter 11 context.[6]

We agree with the Third Circuit that standing need not be limited to trustees and debtors in possession. We do not decide whether a third party claimant should have standing only in those cases in which the trustee or debtor in possession has refused the third party's request to recover the property.[7]

REVERSED and REMANDED.

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[6] Since this case does not present the issue, we do not decide whether these policies would dictate a narrow standing rule in Chapter 7 cases.

[7] See Footnote 5.

APPENDIX B

UNITED STATES BANKRUPTCY
APPELLATE PANEL OF THE
NINTH CIRCUIT

Bankruptcy No. 88-02459-LM11
BAP No. SC-89-1249-VJR

IN RE PALOMAR TRUCK CORPORATION, dba PALOMAR, R.V.,
Debtor.

NORTH COUNTY JEEP AND RENAULT, INC.,
Appellant,

v.

GENERAL ELECTRIC CAPITAL CORPORATION,
Appellee.

Argued & Submitted Jan. 17, 1990

Decided July 23, 1990

No Appearance by appellant.

Gregory B. Beam, Santa Ana, Cal., for appellee.

Before VOLINN, JONES and RUSSELL, Bankruptcy Judges.

OPINION

VOLINN, Bankruptcy Judge:

OVERVIEW

Appellant North County Jeep & Renault incurred losses while independently operating the debtor's business. It thereafter moved for an order allowing those losses as an administrative expense and sought payment of those losses from a secured creditor, appellee General Electric Credit Corporation, from the proceeds of secured prop-

erty under 11 U.S.C. § 506(c).[1] The bankruptcy court allowed an administrative expense claim in the amount requested but denied the motion for payment of the claim under § 506(c) on the basis that appellant lacked standing to assert a right to repayment under that Code section. Appellant filed this timely appeal. We AFFIRM.

FACTS

The debtor, Palomar Truck Corporation ("Palomar") filed a petition under chapter 11 on March 28, 1988. Palomar operated a motor vehicle dealership. Its assets were subject to security interests in favor of General Motors Acceptance Corporation ("GMAC"), Chrysler Credit Corporation ("CCC"), and other parties not involved with this appeal. The appellee, General Electric Capital Corporation ("GECC"), asserts that it holds a blanket security interest in all Palomar assets, subject only to the superior claims of GMAC and CCC.

The bankruptcy court appointed Steven A. Berkowitz as chapter 11 trustee for the Palomar bankruptcy estate on June 9, 1988. Soon thereafter, the trustee met with James Williams, a representative of appellant North County Jeep and Renault, Inc. ("North County"), to discuss North County's interest in purchasing Palomar's motor vehicle dealership. Mr. Williams and the trustee inspected the physical assets of the Palomar dealership and determined that those assets had a liquidation value of approximately $75,000, an amount insufficient to satisfy the secured claims of GMAC and CCC. After negotiations, North County agreed to purchase the assets of Palomar related to the sale of Jeep and General Motors vehicles, including the franchise rights, for $150,000.

Pending bankruptcy court approval of the sale, North County agreed to operate the Palomar Truck dealership at no expense to the trustee or the estate. Under the

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[1] All chapter and section references herein are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, unless otherwise indicated.

agreement, North County would be entitled to any profits and would bear any losses arising from the operation of the business. At the time of this agreement, Palomar was in default under its flooring agreements with GMAC, CCC, and GECC. The estate had no funds to meet current expenses or operate the business and the business would have closed if North County had not stepped in. Continued operation of the dealership was important because if the business had closed, the franchise agreements with General Motors and Chrysler would have terminated, and presumably the value of the business would have been significantly reduced.

The bankruptcy court heard the trustee's motion for authority to sell the Palomar assets to North County on July 6, 1988. Although North County and the trustee had apparently agreed that North County's offer would not be subject to overbid, the bankruptcy court determined in its discretion that overbids would be permitted. The successful bidder, Sunroad Capital Corporation purchased the Palomar assets for $495,000 and assumed operating responsibilities for the dealership on July 6, 1988. GMAC and CCC have been or will be paid in full from the sale proceeds. GECC apparently claims that it is entitled to the remaining sale proceeds.

Subsequently, North County moved for allowance of administrative expenses in the sum of $66,601.79, which was the amount of its net operating loss during the time it operated the Palomar dealership under the agreement with the trustee. North County further requested that the expenses be paid from property securing GECC's allowed secured claim under § 506(c).[2] GECC objected. At a hearing on January 5, 1989, the bankruptcy court orally granted North County's motion to have its operating losses allowed as an administrative expense, but ruled that North County lacked standing to recover its

[2] The trustee also filed a motion for recovery of his costs and expenses under § 506(c). That motion is not at issue in this appeal.

administrative expense claim under § 506(c). On March 13, 1989, the bankruptcy court entered its written order, and also entered an order denying North County's motion for reconsideration of the § 506(c) ruling. North County timely filed this appeal.

ISSUE

Whether a party other than the trustee has standing under § 506(c) to recover from property securing an allowed secured claim its reasonable and necessary costs and expenses of preserving such property.

STANDARD OF REVIEW

Statutory interpretation involves an issue of law and is subject to *de novo* review. *See In re Orvco, Inc.*, 95 B.R. 724, 726 (9th Cir. BAP 1989).

DISCUSSION

The bankruptcy court held that North County lacked standing to seek payment of its allowed administrative claim under § 506(c). Section 506(c) provides as follows:

> The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim.

Section 506(c) was intended as a codification of a line of cases applying the equitable principle that a lienholder may be charged with the reasonable costs and expenses required to preserve or dispose of the collateral, when incurred by the debtor, debtor-in-possession, or trustee. 3 *Collier on Bankruptcy* ¶ 506.06 at 506-55 (15th ed. 1989); *see also* H.R.Rep. No. 95-595, 95th Cong., 1st Sess. 357 (1977); S. Rep. No. 95-989, 95th Cong., 2d Sess. 68 (1978); U.S. Code Cong. & Admin.News 1978,

5787, 5854, 6312-6313. The legislative history of § 506 (c) states in part that

> Any time the trustee or debtor-in-possession expends money to provide for the reasonable and necessary costs and expenses of preserving or disposing of a secured creditor's collateral, the trustee or debtor-in-possession is entitled to recover such expenses from the secured party or from the property securing an allowed secured claim held by such party.

124 Cong.Rec. H11095 (daily ed. Sept. 28, 1978) (remarks of Rep. Edwards); S17411 (daily ed. Oct. 6, 1978) (remarks of Sen. DeConcini).

Although the specific language of § 506(c) and its legislative history appear to restrict recovery under that section to the trustee,[3] courts are divided on the question of whether standing under § 506(c) is so limited. Many courts have held that standing under § 506(c) is strictly limited to the trustee, and have barred other parties from recovering under that section. *See e.g., In re Interstate Motor Freight System IMFS, Inc.*, 71 B.R. 741 (Bankr.W.D.Mich.1987) (*"IMFS I"*); *In re Dakota Lay'd Eggs*, 68 B.R. 975 (Bankr.D.N.D. 1987); *In re Codesco, Inc.*, 18 B.R. 225, 230 (Bankr.S.D.N.Y.1982). Other courts have held that standing is not so limited and have allowed entities other than the trustee to recover under § 506(c). *See e.g., In re McKeesport Steel Castings Co.*, 799 F.2d 91 (3d Cir.1986); *In re Staunton Indus., Inc.*, 74 B.R. 501 (Bankr.E.D.Mich.1987).[4]

---

[3] For purposes of this discussion, references to the standing of the trustee under § 506(c) shall be deemed to include a Chapter 11 debtor-in possession pursuant to § 1107(a), which provides in pertinent part as follows:

> [A] debtor in possession shall have all the rights . . . and powers, and shall perform all the functions and duties . . . of a trustee serving in a case under this chapter.

[4] We are unaware of any Ninth Circuit or Panel decisions addressing this issue. In *In re Sonoma V*, 24 B.R. 600 (9th Cir. BAP 1982)

The reasoning of the courts that have limited standing to the trustee is based on the language of the statute and its legislative history, under which the trustee is the only entity expressly granted authority to recover administrative expenses. *See, e.g., Dakota Lay'd Eggs*, 68 B.R. at 978; *Codesco*, 18 B.R. at 230.

Courts adopting a more expansive view of standing under § 506(c) point out that while that section by its terms grants the trustee authority to recover administrative costs and expenses from the collateral of the benefitted secured creditor, it "does not definitively state that no other entity may do so." *Staunton Indus.*, 74 B.R. at 504. The *Staunton* court also pointed out that the perceived violation of § 726(b) described by the *IMFS I* court presupposes the conclusion that only the estate, and not a particular creditor, may recover under § 506(c), stating:

> It is not clear to this Court, however, why recovery of monies expended by third parties to protect the secured creditor's collateral *should* flow into the general estate to be subject to § 726(b). Thus, the rationale of *Interstate Motor Freight* begs the question.

74 B.R. at 506 (emphasis added). These courts also note the inequitable result that may flow from denying recovery to the administrative claimant when the trustee fails or refuses to act. *See, e.g., McKeesport Steel*, 799 F.2d at 94. This result could occur where the trustee has no incentive to pursue a § 506(c) recovery or may be hostile to the claimant. *See id.; see also In re Chicago*

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the Panel did indicate that fees of the attorney for the debtor may be charged to the secured creditor under § 506(c) where it is demonstrated that the secured creditor derived a benefit from the services. Although *In re Loop Hospital Partnership*, 50 B.R. 565 (Bankr. N.D.Ill.1985), relied upon *Sonoma* to determine that attorneys may petition for fees under § 506(c), the *Sonoma* decision did not discuss or analyze standing under § 506(c). A close reading of the decision does not reflect whether it was the reorganized debtor or the attorneys themselves who sought recovery under § 506(c).

Lutheran Hosp. Assoc., 89 B.R. 719, 726 n. 9 (Bankr. N.D.Ill.1988); 3 *Collier on Bankruptcy* ¶ 506.06, at 506-57 n. 7a (15th ed. 1989).

Collier on Bankruptcy concurs in the more expansive interpretation of standing under § 506(c). After reviewing those cases which have adopted the strict interpretation, the author states that "[t]hese cases represent the minority view," and concludes that:

> The better view is that a secured creditor who received a direct benefit from the rendition of services or provision of goods by an administrative claimant of the estate should have the collateral charged for such benefit. . . . Otherwise, if the debtor, debtor in possession or trustee does not have available funds to pay the claimant, the debtor, debtor in possession or trustee has no economic incentive to seek recovery under [§ 506(c)] of amounts which will be paid over to the claimant and, as a result, the secured creditor obtains a windfall at the expense of the unpaid claimant.

3 *Collier on Bankruptcy*, ¶ 506.06, at 506-57 n. 7a (15th ed. 1989).

North County argues that its operation of the debtor's dealership allowed the dealership's General Motors and Chrysler franchises to be maintained, thereby preserving that portion of the estate to GECC's benefit; if the franchises had not been maintained, the value of GECC's collateral would have been substantially reduced. North County also argues that it is the only party with an interest in bringing an action under § 506(c) because the trustee has no interest in bringing an action where any recovery which may be had would be paid over to North County.

North County principally relies on *McKeesport Steel* and *Staunton Indus.* as authority for the expansive interpretation of § 506(c) it urges we adopt in this case.

However, two significant factors distinguish *McKeesport Steel* and *Staunton Indus.* from the present case. First, in both cases the orders of the court were significantly involved in the arrangements which caused the claimant's administrative expense claim to accrue. Prior court approval stamps the claimant's subsequent actions with the court's imprimatur and causes the claimant to justifiably rely on the fact that it will be repaid, regardless of whether the trustee has the economic motivation to seek that repayment for the claimant. Prior court approval of arrangements leading to an administrative claim provides the claimant with a more colorable right to assert a § 506(c) claim.

Second, in both *McKessport Steel* and *Staunton Indus.* the § 506(c) claimant was continuing, after bankruptcy, a pre-existing business relationship with the debtor when it incurred the expense for which it sought reimbursement. The utility in *McKeesport Steel* in fact sought to terminate its relationship with the debtor, but was barred from doing so by the court. In both of these two cases the claimant simply continued as before pursuant to a court order.

But here, there is no indication in the record that North County had any connection with the debtor prior to the time it entered into the operating agreement. North County, by entering into the agreement, embarked voluntarily on a new venture which it knew could result in either gain or loss. Obviously it anticipated a gain, hoping to earn an operating profit, and more important, to purchase the business at a favorable price.

North County further relies upon certain equitable factors set forth in a footnote in *In re Loop Hospital Partnership:*

> (1) Was there a reasonable expectation of consummation or success for the reorganization;

(2) Were the services done primarily to protect unsecured creditors and debt or was due regard also had for the secured creditor's interest;

(3) Were the services performed with reasonable diligence and confidence;

(4) Were the secured creditors benefited by anything done in the reorganization;

(5) Did the secured creditors consent, waive objection or request;

(6) Were the secured creditors responsible for any delays or uncooperative in attempts to formulate an acceptable plan.

50 B.R. 565, 571 (Bankr.N.D.Ill. 1985).

While these factors provide a basis for consideration of § 506(c) charges by a non-trustee, they provide little support for North County's position. The only relevant factor favoring North County is that the secured creditor in this case, GECC may have benefited by North County's operation of the business. However, North County did not enter into the operating agreement with the consent of GECC. It proceeded on its own initiative on a non-competitive bid, hoping to purchase the business at an advantageous price. North County did not obtain the consent of any of the secured creditors to enter into the agreement. There is insufficient evidence in the record to apply the remaining factors.

This is not a case to consider adoption of the more expansive view of standing because the facts before us would not justify its application. Here a disappointed bidder seeks to impose the cost of its gamble on the holder of a security interest in property. North County was not simply performing a caretaker function respecting the operation of the dealership, but was entitled to retain whatever profits its business operations generated; concurrent with the profit potentiality was the risk of in-

curring losses. It also operated the business hoping for the benefit of a purchase based on a non-competitive bid.

CONCLUSION

North County neither sought nor obtained court approval before it entered into the agreement to operate the debtor's business. It has made no showing that the secured creditor should be obligated to contribute to the expense North County has incurred. Nor has North County shown that the estate may be faced with a charge by it for which the estate might claim indemnification from the secured creditor.[5] We conclude that the circumstances of this case do not endow appellant with standing to seek relief under § 506(c). The judgment of the bankruptcy court is AFFIRMED.

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[5] We note that the trial order has allowed the North County charges as a general expense of administration.

APPENDIX C

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA

Case No. 88-02459-LM11

IN RE: PALOMAR TRUCK CORPORATION, A California corporation, doing business as Palomar, R.V.,
Debtor

ORDER GRANTING MOTION ALLOWING ADMINISTRATIVE EXPENSE AND DENYING MOTION TO PAY ADMINISTRATIVE EXPENSE FROM PROPERTY SUBJECT TO SECURITY INTEREST

[Filed Mar. 13, 1989]

The motion of North County Jeep and Renault, Inc. ("North County") for allowance of administrative expense and to pay administrative expense from property subject to security interests came on regularly for hearing on January 5, 1989 at 3:30 p.m. in Department 2 of the above entitled court, the Honorable Louise DeCarl Malugen, United States Bankruptcy Judge presiding. Appearances were made by David L. Buchbinder, Esq. on behalf of Steven A. Berkowitz, Trustee, who was also present. Alan L. Williams, Esq. appeared on behalf of North County, Mark A. Kompa of Hart, King, & Coldren appeared on behalf of creditor General Electric Capital Corporation, Eric Lund, Esq. appeared on behalf of creditors Thomas P. Olvaney and Mary Jean Olvaney,

Gary Slater of Hinchy, Witte, Wood, Anderson and Hodges appeared on behalf of Sunroad Capital Corporation, Sigmund Luther of Brown, McDonald and Ravin appeared on behalf of Julius Pearl and Larry Ramie appeared on behalf of the United States Trustee.

The Court, hereby orders as follows:

1. Creditor North County Jeep and Renault, Inc., a California corporation, is allowed an administrative expense claim in the amount of $66,601.79.

2. The motion of North County to obtain payment of the allowed administrative expense claim from property subject to security interests is denied on the ground that Movant lacks standing to bring such a motion under Title 11 United States Code Section 506(c).

LOUISE DECARL MALUGEN
United States Bankrupcty Judge

Dated: Mar. 13, 1989

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 90-56112

BAP No. SC-89-1249-VJR

IN RE PALOMAR TRUCK CORPORATION, dba PALOMAR, R.V.,
Debtor,

NORTH COUNTY JEEP AND RENAULT, INC.,
Appellant,

v.

GENERAL ELECTRIC CAPITAL CORPORATION,
Appellee.

ORDER

[Filed Feb. 27, 1992]

Before: BROWNING, ALARCON and T.G. NELSON, Circuit Judges.

The panel has voted to deny the first amended petition for rehearing and to reject the suggestion for rehearing en banc.

The full court has been advised of the suggestion for rehearing en banc and no active judge has requested a vote on whether to rehear the matter en banc. Fed. R. App. P. 35.

The first amended petition for rehearing is denied and the suggestion for rehearing en banc is rejected.

APPENDIX E

UNITED STATES BANKRUPTCY
APPELLATE PANEL OF THE
NINTH CIRCUIT

BAP No. SC-89-1249-VJR

Bankruptcy No. 88-02459-LM11

Adversary No.

IN RE PALOMAR TRUCK CORPORATION, dba PALOMAR R.V.,
Debtor.
NORTH COUNTY JEEP AND RENAULT INC.,
Appellants,
vs.
GENERAL ELECTRIC CAPITAL CORPORATION,
Appellee.

[Filed Aug. 23, 1990]

Before: VOLINN, JONES and RUSSELL, Bankruptcy Judges

The Panel has considered the Appellant's Motion For Rehearing and the Appellee's Opposition. The motion for rehearing is hereby ORDERED DENIED.

APPENDIX F

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA

Case No. 88-02459-LM11

IN RE: PALOMAR TRUCK CORPORATION, A California corporation, doing business as Palomar, R.V.,
Debtor

ORDER DENYING MOTION FOR RECONSIDERATION

[Filed Mar. 13, 1989]

The motion of North County Jeep and Renault, Inc. for reconsideration of its motion to pay administrative expense from property subject to security interest came on regularly for hearing February 16, 1989 at 3:00 p.m. in Department 2 of the above entitled Court, the Honorable Louise DeCarl Malugen, United States Bankruptcy Judge, presiding.

Appearances were made by Flora L. Claem, Esq. on behalf of Steven A. Berkowitz, Trustee, who was also present. Alan L. Williams, Esq. appeared on behalf of North County Jeep and Renault, Inc., Mark A. Kompa of Hart, King, & Coldren appeared on behalf of creditor General Electric Capital Corporation, and Eric Lund, Esq. appeared on behalf of creditors Thomas P. Olvaney and Mary Jean Olvaney.

After considering the papers and pleadings on file in this action, and after hearing the argument of counsel, the Court made its order as follows:

IT IS ORDERED THAT the motion of North County Jeep and Renault, Inc. for reconsideration of the prior

ruling made by this Court on January 5, 1989, with respect to the motion to pay administrative expense from property subject to security interests, is DENIED.

LOUISE DECARL MALUGEN
United States Bankruptcy Judge

Dated: Mar. 13, 1989

(2)

FILED
JUN 26 1992
OFFICE OF THE CLERK

No. 91-1901

In The

Supreme Court of the United States

October Term, 1991

GENERAL ELECTRIC CAPITAL CORPORATION,

Petitioner,

v.

NORTH COUNTY JEEP & RENAULT, INC.,

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

ALAN L. WILLIAMS
Counsel of Record
ELIZABETH A. KREITZER
LAW OFFICES OF ALAN L. WILLIAMS
1650 Hotel Circle North, Suite 210
San Diego, California 92108
(619) 296-0196

Attorneys for Respondent

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

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QUESTION PRESENTED

Did the Ninth Circuit properly conclude that an administrative expense claimant has standing under 11 U.S.C. § 506(c)[1] to recover from property securing an allowed secured claim its reasonable and necessary costs and expenses of preserving such property.

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[1] All chapter and section references herein are to the Bankruptcy Code, 11 USC § 101-1330, unless otherwise indicated.

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No. 91-1901

In The

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October Term, 1991

GENERAL ELECTRIC CAPITAL CORPORATION,

Petitioner,

v.

NORTH COUNTY JEEP & RENAULT, INC.,

Respondent.

Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

TO THE HONORABLE WILLIAM H. REHNQUIST, CHIEF JUSTICE, AND TO THE HONORABLE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

North County Jeep and Renault, Inc. ("North County" or "Respondent") respectfully submits this opposition to General Electric Capital Corporation's ("GECC" or "Petitioner") Petition for Writ of Certiorari.

PROVISION OF LAW INVOLVED

The single provision of federal law in question is § 506(c) of the Bankruptcy Code, Title 11 of the United States Code, which states:

> The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving or disposing of, such property to the extent of any benefit to the holder of such claim.

STATEMENT OF THE CASE

Palomar Truck Corporation ("Palomar") filed a voluntary petition for relief under the provisions of Chapter 11 of the Bankruptcy Code in March 1988 and served as debtor-in-possession until June 1988, when the Court appointed a Trustee for the Palomar estate. Respondent negotiated an agreement with the Trustee by the terms of which Respondent would purchase Palomar's motor vehicle dealership. Respondent agreed to operate Palomar as agent for the Trustee while the Trustee obtained Court approval of Respondent's purchase.

In July 1988, the Trustee's motion to sell the dealership to Respondent came on for hearing in the United States Bankruptcy Court, Southern District of California. Notwithstanding the representation of the Trustee to Respondent that the offer of Respondent would not be subject to overbid, the Court found that it had discretion to entertain overbids. The successful bidder was Sunroad

Capital Corporation with a bid of $495,000.00. Upon Sunroad Capital Corporation's successful bid, Respondent immediately terminated its operation of Palomar.

In February 1989, Respondent brought its motion before the United States Bankruptcy Court, Southern District of California, seeking allowance of administrative expenses in the amount of $66,601.79 (the amount of Respondent's operating loss during its interim operation of the business on behalf of the Trustee), and for an order that the allowed administrative expense be paid from properties securing a secured claim.

Respondent's motion that the operating loss be allowed as an administrative expense was granted in the amount prayed for. However, the Court ruled as a matter of law that Respondent lacked standing to recover its administrative expense under § 506(c) which provides for recovery of administrative expenses from property securing an allowed secured claim. (Petition Appendix, at 17a-18a.)

Respondent filed a timely appeal with the Bankruptcy Appellate Panel for the Ninth Circuit from the Bankruptcy Court's ruling as a matter of law that Respondent lacked standing to recover its administrative expense under § 506(c). On July 23, 1990, the Bankruptcy Appellate Panel filed its opinion affirming the Bankruptcy Court's order. (Petition Appendix, at 7a-16a.) Respondent filed its Motion for Rehearing on August 2, 1990. The Bankruptcy Appellate Panel's Order denying Respondent's Motion for Rehearing was entered on August 23, 1990. (Petition Appendix, at 20a.)

Respondent then filed a timely appeal with the United States Court of Appeals for the Ninth Circuit from the Bankruptcy Appellate Panel's ruling affirming the Bankruptcy Court's order. On December 16, 1991, the United States Court of Appeals filed its opinion reversing and remanding the Bankruptcy Appellate Panel's order. (Petition Appendix, at 1a-6a.) The United States Court of Appeals for the Ninth Circuit agreed with the United States Court of Appeals for the Third Circuit that standing need not be limited to trustees and debtors in possession. *Ibid.*

Petitioner filed its Petition for Rehearing and Suggestion That Rehearing Be En Banc on or about December 28, 1991 and its First Amended Petition for Rehearing and Suggestion That Rehearing Be En Banc on or about December 30, 1991. The United States Court of Appeals' Order denying Petitioner's First Amended Petition for Rehearing and rejecting the suggestion for rehearing en banc was entered on February 27, 1992. (Petition Appendix, at 19a.)

REASONS FOR DENYING PETITION

I

THE PETITION FOR WRIT OF CERTIORARI FAILS TO MEET THE SUPREME COURT RULE 10 STANDARD OF PRESENTING SPECIAL OR IMPORTANT REASONS FOR REVIEW ON WRIT OF CERTIORARI

The petition for writ of certiorari does not meet the standard of Supreme Court Rule 10. The Rule provides, in pertinent part:

> A review on writ of certiorari is not a matter of right, but of judicial discretion. A petition for a writ of certiorari will be granted only when there are special and important reasons therefor.

Rule 10 lists several reasons that might satisfy this high standard. Petitioner does not even arguably fit within any reason except the provision of Subsection 10(c), which provides that review may be proper when "a United States court of appeals has decided an important question of federal law which has not been, but should be, settled by this Court. . . . "

Yet here, although the Ninth Circuit decided a matter of importance, the court did not depart from established legal precedent. Standing need not be limited to trustees and debtors in possession[2] under § 506(c) to recover from property securing an allowed secured claim the reasonable and necessary costs and expenses of preserving such property. *See, e.g., In re McKeesport Steel Castings Co.*, 799 F.2d 91 (3rd Cir. 1986); *Matter of Delta Tower, Ltd.*, 924 F.2d 74 (5th Cir. 1991); *In re Parque Forestal, Inc.*, 949 F.2d 504 (1st Cir. 1991); *In re T.P. Long Chemical, Inc.*, 45 Bankr. 278 (Bankr. N.D. Ohio 1985); *In re Isaac Cohen Clothing Corp.*, 39 Bankr. 199 (Bankr. S.D.N.Y. 1984). Courts have extended standing under § 506(c) to those administrative expense claimants discharging a duty of the trustee (*see, e.g., In re T.P. Long Chemical Inc.*, 45 Bankr. 278, 287), where the administrative expenses were reasonable, necessary and the secured creditors benefitted from the expenses (*see Matter of Delta Tower, Ltd.*, 924 F.2d 74).

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[2] *See* § 1107(a) entitling a debtor in possession to the rights and powers of a trustee in a case under Chapter 11.

Here, Petitioner does not contend that the Court of Appeals failed to consider whether Respondent was discharging a duty of the trustee or whether the expenses were indeed administrative expenses. It is undisputed that but for Respondent's interim operation of the Palomar estate, "the business would have closed, the franchise agreements would have been terminated and 'presumably the value of the business would have been significantly reduced.' " *In re Palomar Truck Corp.*, 951 F.2d 229 (9th Cir. 1991).

Rather, Petitioner disputes the outcome of the Ninth Circuit's conclusion that on the facts of this particular case, Respondent does have standing under § 506(c) to recover from property securing an allowed secured claim its reasonable and necessary costs and expenses of preserving such property. Therefore, Petitioner fails to satisfy Rule 10 because the Ninth Circuit's decision does not decide questions of federal law which have not been, but should be, settled by this Court.

II

THE COURT BELOW FULLY CONSIDERED AND CORRECTLY DECIDED THE ISSUES

A. Petitioner Overlooks the Facts of This Particular Case In Applying the "Plain Meaning" Rule of Statutory Construction.

As Petitioner indicates, "[t]he plain meaning of the legislation should be conclusive, except in the 'rare cases' [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its

drafters." (Petition, at 9 citing *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242 (1989).)

Here, Respondent agreed to operate the Palomar estate as agent *for the Trustee* while the Trustee obtained Court approval of Respondent's purchase of Palomar. It is undisputed that Respondent's operation of the Palomar estate greatly benefited Petitioner in preserving the going concern value of the business and saving the franchise agreements from termination. *In re Palomar Truck Corp.*, 951 F.2d 229 (9th Cir. 1991). It is also undisputed that the Trustee has no economic incentive to seek recovery under § 501(c) since recovery passes directly to Respondent, not the Palomar estate. Petitioner's failure to reimburse Respondent its reasonable and necessary costs and expenses of preserving the Palomar estate will result in a windfall for Petitioner at the expense of Respondent.

The Ninth Circuit fully considering the facts particular to the case and agreeing with the Third Circuit, correctly decided that standing under § 506(c) need not be limited to trustees and debtors in possession. *Ibid.* Where the trustee has "no economic incentive to seek recovery under § 506(c) since the recovery would pass to the claimant with no gain to the estate" and failure to grant the claimant standing would result in "a windfall for the secured creditor at the expense of the unpaid claimant", standing under § 506(c) may be extended to third-party claimants. *Ibid.*

The exception to the "plain meaning" rule correctly applies in cases where the trustee fails to seek recovery under § 506(c) and failure to grant the claimant standing

under § 506(c) results in a windfall to the secured creditor.

B. The Bases for Granting Third Party Standing Under § 506(c) Is a Well Defined Standard.

The Third Circuit in *McKeesport* reasoned that a third party claimant had standing under § 506(c) since the trustee had no reason to make a claim on claimant's behalf. *In re McKeesport Steel Castings Co.*, 799 F.2d 91, 94 (3rd Cir. 1986). In addition, the Third Circuit reasoned that failure to grant the third party claimant standing under § 506(c) would result in failure of a justified claim being brought against the secured creditors. *Ibid.*

The Ninth Circuit directly bases its reasoning in this case on the reasoning applied by the Third Circuit in *McKeesport*. The Ninth Circuit in *Palomar* states in pertinent part:

> Like the trustee in *McKeesport*, the trustee here had no economic incentive to seek recovery under § 506(c), since the recovery would pass to the claimant with no gain to the estate. As in *McKeesport*, if only the trustee were allowed standing, the result would be a windfall for the secured creditor at the expense of the unpaid claimant. . . . We agree with the Third Circuit that standing need not be limited to trustees and debtors in possession.

In re Palomar Truck Corp., 951 F.2d 229 (9th Cir. 1991).

The Fifth Circuit in *Delta Tower* also directly relies on the reasoning in *McKeesport* in granting standing to third party claimants. *Matter of Delta Tower, Ltd.*, 924 F.2d 74, 76

(5th Cir. 1991). The Fifth Circuit in *Delta Tower*, citing *McKeesport*, states in pertinent part:

> [C]ourts have allowed a claimant to use § 506(c) if the trustee or debtor-in-possession refuses to pursue a claim of administrative expenses.

Ibid. The Fifth Circuit continues by reasoning that the failure to grant a third party standing may result in a windfall benefit to the secured creditors at the third party's expense. *Ibid.*

Finally, the First Circuit in *Parque Forestal* relies on the reasoning in *McKeesport* in granting standing to third party claimants. *In re Parque Forestal, Inc.*, 949 F.2d 504, 511-512 (1st Cir. 1991). The First Circuit reasoned that a third party should be granted standing where the third party has a justifiable claim against the secured creditors and the trustee has no incentive to pursue the claim. *Ibid.*

Petitioner mistakenly attempts to distinguish the reasoning of the Court of Appeals cases purely on semantics employed by the Courts, not reasoning employed by the Courts. A simple reading of Court of Appeals cases cited above clearly defines the standard for granting a third party standing under § 506(c). A third party may be granted standing under § 506(c) where the trustee has no incentive to seek recovery under § 506(c) and failure to pursue the claim would result in a windfall for the secured creditors at the expense of the unpaid claimant.

C. Permitting Third Party Standing Under § 506(c) Is Severely Limited.

Petitioner's assertion that permitting third party standing under § 506(c) creates chaos is unfounded and unreasonable.

First, the third party must have an administrative expense claim under § 503(b) before seeking standing under § 506(c). In order to charge a secured creditor with an administrative expense, the expense must meet three (3) criteria: (1) the expense must be a necessary expense, (2) the amount expended must be reasonable, and (3) the creditor must benefit from the expense. *Matter of Delta Towers, Ltd.*, 924 F.2d 74, 76 (5th Cir. 1991) citing *In re Trim-X, Inc.*, 695 F.2d 296, 299 (7th Cir. 1982).

Second, as outlined above, the trustee must have no incentive to seek recovery under § 506(c) for a third party to be granted standing under § 506(c). *In re McKeesport Steel Castings Co.*, 799 F.2d 91 (3rd Cir. 1986); *In re Palomar Truck Corp.*, 951 F.2d 229 (9th Cir. 1991); *Matter of Delta Tower, Ltd.*, 924 F.2d 74 (5th Cir. 1991); *In re Parque Forestal, Inc.*, 949 F.2d 504 (1st Cir. 1991).

Third, failure to pursue the claim must result in a windfall for the secured creditors at the expense of the unpaid claimant for a third party to be granted standing under § 506(c). *Ibid.*

Finally, the standard set forth in granting third party standing under § 506(c) would more than likely not apply to Chapter 7 liquidation cases. *See In re Palomar Truck Corp.*, 951 F.2d 229 (9th Cir. 1991). In Chapter 7 liquidation cases, there is a great need for the trustee to maintain

control of the liquidation of the estate. *Ibid.* A narrow reading of § 506(c) in Chapter 7 liquidation cases preserves the policy favoring parity of payment to all claimants in a class under § 726. *Ibid.*

The limitations placed on third party standing under § 506(c) demonstrate Petitioner's insupportable assertion of creating chaos in the administration of bankruptcy cases.

CONCLUSION

Petitioner's arguments fail to recognize the facts particular to this case which support the decision of the Ninth Circuit. The Ninth Circuit fully considered and correctly decided the issue of third party standing under § 506(c) recognizing the particular facts that the trustee has no incentive to pursue this matter under § 506(c) and that failure to grant Respondent standing under § 506(c) will result in a windfall for Petitioner at Respondent's expense. Petitioner fails to show why this Court should reach a different result than the Ninth Circuit. Therefore, the petition should be denied and the Court should award Respondent all allowable attorneys' fees and costs.

Respectfully submitted,

ALAN L. WILLIAMS
Counsel of Record
ELIZABETH A. KREITZER
LAW OFFICES OF ALAN L. WILLIAMS
1650 Hotel Circle North, Suite 210
San Diego, California 92108
(619) 296-0196

Attorneys for Respondent

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No. 91-1901

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

GENERAL ELECTRIC CAPITAL CORPORATION,
Petitioner,

v.

NORTH COUNTY JEEP & RENAULT, INC.,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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PETITIONER'S REPLY BRIEF

IRVING SULMEYER
Counsel of Record
LEWIS RAYMOND LANDAU
SUSAN FRANCES MOLEY
SULMEYER, KUPETZ, BAUMANN & ROTHMAN
A Professional Corporation
300 South Grand Avenue
14th Floor
Los Angeles, California 90071
(213) 626-2311
Attorneys for Petitioner, General Electric Capital Corporation

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTIONS PRESENTED

1. Bankruptcy Code § 506(c) provides that a bankruptcy trustee or debtor in possession may recover from, or "surcharge", a secured creditor's collateral for the reasonable, necessary costs and expenses of preserving, or disposing of, such collateral to the extent of any benefit to the secured creditor. Did the Ninth Circuit err in extending standing to surcharge a secured creditor's collateral under 11 U.S.C. § 506(c) to third parties other than trustees and debtors in possession in contravention of the plain and unambiguous text of the statute and the statute's legislative history?

If the Court concludes that Section 506(c) standing is available to third parties, then the following additional question is presented for determination:

2. Did the Ninth Circuit err by failing to set forth the parameters for permitting third party standing under 11 U.S.C. § 506(c) upon which bankruptcy administrators and secured creditors can rely?

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On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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PETITIONER'S REPLY BRIEF

General Electric Capital Corporation, ("GECC" or "Petitioner") respectfully replies to the Opposition to Petition for Writ of Certiorari ("Opposition") submitted by North County Jeep & Renault, Inc. ("Respondent").

I. GECC HAS SATISFIED THE SUPREME COURT RULE 10 REQUIREMENT FOR ITS PETITION FOR WRIT OF CERTIORARI TO BE GRANTED DUE TO THE IMPORTANCE OF THE ISSUE OF THIRD PARTY STANDING UNDER 11 U.S.C. § 506(c) TO THE ADMINISTRATION OF BANKRUPTCY LAWS AND DUE TO THE CASE BEING ONE OF FIRST IMPRESSION BEFORE THIS COURT

The issue presented for review by this Court is of significant importance to the administration of bankruptcy laws. Respondent concedes that the "Ninth Circuit decided a matter of importance" in the case at bar. Opposition at p. 5. The significance of the Ninth Circuit's decision is that its refusal to adhere to the "plain meaning" rule of statutory construction has eradicated the predictability established in the United States Bankruptcy Code. The Ninth Circuit's decision will spawn a multiplicity of lawsuits which will directly and significantly impact the administration of bankruptcy laws and the dockets of the bankruptcy court system. Hence, Petitioner has satisfied the Supreme Court Rule 10 requirement for a Writ of Certiorari to issue in accordance with *Reading Company v. Brown*, 391 U.S. 471 (1968).

The Ninth Circuit has violated the "plain meaning" rule of statutory construction by interpreting the clear, unambiguous text of 11 U.S.C. § 506(c), which specifically states that only "the trustee may,"[1] to also allow third party standing in surcharge actions. Such an interpretation is neither warranted by the text of the statute nor its legislative history. Permitting third party standing under 11 U.S.C. § 506(c) will potentially result in innumerable surcharge actions because it would behoove any administrative claimant to seek to surcharge the collateral of a secured creditor in order to elevate the status of its unsecured claim, which would share equally with other general administrative claims, to the status of a

[1] And by operation of 11 U.S.C. § 1107, "the debtor in possession may."

superpriority or secured claim, which may receive payment in full.

The Ninth Circuit's holding is at variance with the cases construing other provisions of the United States Bankruptcy Code stating "the trustee may" [2] as limiting standing to trustees, debtors in possession, and in severely restricted circumstances, to third parties who are granted derivative standing. Moreover, the Ninth Circuit's interpretation of the term "trustee" to mean "trustee or creditor" is also in tension with several Courts of Appeals decisions holding that the term "trustee", used elsewhere in the code, specifically excludes "creditors". *See, e.g., In re Pointer*, 952 F.2d 82, 87-88 (5th Cir. 1992) (section 549); *Saline State Bank v. Mahloch*, 834 F.2d 690, 694 (8th Cir. 1987) (section 544); *Delgado Oil Co., Inc. v. Torres*, 785 F.2d 857, 860 (10th Cir. 1986) (section 547). Finally, the Ninth Circuit's holding fails to observe this Court's mandate that the interpretation of a United States Bankruptcy Code section should "accord with the prevailing interpretations of [the words] as [they] appear elsewhere in the Code." *Patterson v. Shumate*, —— U.S. ——, 112 S.Ct. 2242, 2247, 60 U.S.L.W. 4550 (1992).

II. THIS CASE DOES NOT MERIT AN EXCEPTION TO THE "PLAIN MEANING" RULE OF STATUTORY CONSTRUCTION

The "plain meaning" rule of statutory construction dictates that "[t]he plain meaning of legislation should be conclusive, except in the 'rare cases' [in which] the

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[2] *See* e.g., 11 U.S.C. § 327—"the trustee may employ"; 11 U.S.C. § 363(b)—"the trustee . . . may use, sell or lease"; 11 U.S.C. § 364—"the trustee may obtain unsecured credit"; 11 U.S.C. § 365—"the trustee . . . may assume"; 11 U.S.C. § 544—"the trustee may avoid"; 11 U.S.C. § 545—"the trustee may avoid"; 11 U.S.C. § 547—"the trustee may avoid"; 11 U.S.C. § 548—"the trustee may avoid"; 11 U.S.C. § 549—". . . the trustee may avoid"; 11 U.S.C. § 550—". . . the trustee may recover."

literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters." *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242 (1989) (citation omitted). This Court has recently stated that where the text of a statute is clear, the party requesting a departure from the text bears an "exceptionally heavy" burden of persuading the Court that Congress intended otherwise. *Patterson v. Shumate*, —— U.S. ——, 112 S.Ct. 2242, 2248, 60 U.S.L.W. 4550 (1992), *citing Union Bank v. Wolas*, 502 U.S. ——, ——, 112 S. Ct. 527, 530, 116 L.Ed.2d 514 (1991). Respondent contends that this case is one of those "rare cases" that qualifies as an exception to the "plain meaning" rule of statutory construction. Respondent's contention is based upon two factors.

First, Respondent claims that in operating the Palomar Truck Corporation ("Palomar") automobile dealership, it was "acting as agent *for the trustee*." Opposition at p. 7. Respondent's assertion is totally unsupported by the facts of this case because (1) the Operating Agreement between Respondent and the trustee did not provide that Respondent was either acting as agent for the trustee or even discharging a duty of the trustee; (2) Respondent has never before in the record of this case claimed to have acted as the "trustee's agent"; and (3) Respondent and the trustee, as buyer and seller respectively, had adverse interests and the Operation Agreement merely provided that Respondent commenced operation of the Palomar automobile dealership prior to the terms of the sale being finalized, which is a typical provision in automobile dealership purchase agreements. Respondent now seeks to be recompensed by GECC for the loss it unfortunately sustained during its operation of the Palomar automobile dealership. Any amounts recovered will go straight into Respondent's pocket. That fact alone obviates any possibility that Respondent acted as an agent for, or discharged a duty of, the trustee, for a bankruptcy trustee must act for the benefit of the

estate, not to advance his own self-interests. *Mosser v. Darrow*, 341 U.S. 267, 271 (1951).

Second, Respondent claims that an exception to the "plain meaning" rule of statutory construction should be made where "failure to grant [a third party administrative claimant] standing [under 11 U.S.C. § 506(c)] would result in a windfall for the secured creditor at the expense of the unpaid claimant." Opposition at p. 7. No such exception to the "plain meaning" rule of statutory construction exists. Courts may not use equitable considerations to depart from the confines of the United States Bankruptcy Code and disregard unambiguous statutory language. *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988) (whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code.)

Respondent has not met its "exceptionally heavy" burden of persuading this Court for a departure from the plain, unambiguous text of 11 U.S.C. § 506(c). Contrary to Respondent's contentions, it was not "acting as agent *for the trustee*." Moreover, there is no equitable exception within the confines of the United States Bankruptcy Code permitting a bankruptcy court to compensate for any alleged windfall to secured creditors as a result of adhering to the plain meaning of 11 U.S.C. § 506(c). Hence, third party standing under 11 U.S.C. § 506(c) should be denied.

III. THE BASES UPON WHICH THIRD PARTY STANDING UNDER 11 U.S.C. § 506(c) IS PERMITTED WITHIN THE FIRST, THIRD, FIFTH AND NINTH CIRCUITS ARE NEITHER CLEARLY DEFINED NOR SEVERELY LIMITED

Respondent contends that the bases upon which third party standing is permitted under 11 U.S.C. § 506(c) within the First, Third, Fifth and Ninth Circuits are both clearly defined and severely limited. Respondent alleges that in order for third parties to successfully assert stand-

ing in surcharge actions, the following criteria must be met: (1) the claimant must have an administrative claim under 11 U.S.C. § 503(b); (2) the trustee must have no incentive to seek recovery under 11 U.S.C. § 506(c); and (3) failure to pursue the claim must result in a windfall for the secured creditor at the expense of the unpaid claimant. Opposition at p.10.

A review of the bases upon which third party standing was granted under 11 U.S.C. § 506(c) in the decisions from the four circuit Courts of Appeals reveals that no such clearly defined or severely limited standard exists. The First and Third Circuits appear to be most closely aligned in that the parameters under which third party standing was permitted therein were: (1) where the claimant had a colorable claim for the expenses and was the only creditor that would zealously pursue that claim, and (2) where the trustee had no incentive to make a claim against the secured creditor. *In re Parque Forestal, Inc.*, 949 F.2d 504, 512 (1st Cir. 1991) and *In re McKeesport Steel Castings, Co.*, 799 F.2d 91, 94 (3rd Cir. 1986). However, in the Fifth Circuit the sole basis under which third party standing was granted was that the trustee or debtor in possession had refused to pursue the administrative claim. *Matter of Delta Towers, Ltd.*, 924 F.2d 74, 77 (5th Cir. 1991). Finally, in the case at bar, the Ninth Circuit seemed only interested in whether the trustee or debtor in possession had an economic incentive to pursue the 11 U.S.C. § 506(c) claim. *In re Palomar Truck Corporation*, 951 F.2d 229, 232 (9th Cir. 1991).

Hence, it is clearly evident from a review of the decisions of the four circuits that the bases upon which third party standing under 11 U.S.C. § 506(c) is permitted are neither clearly defined nor severely limited.

CONCLUSION

The questions presented for review by this Honorable Court introduce an issue of grave importance to the administration of bankruptcy laws in a case of first impression. The decision of the Ninth Circuit in the case at bar violates the "plain meaning" rule of statutory construction and was grounded in an equitable exception that simply does not exist within the confines of the United States Bankruptcy Code. Plainly read, the text of the statute dictates that standing under § 506(c) of the Bankruptcy Code, Title 11 of the United States Code, is limited to trustees and debtors in possession.

Respectfully submitted,

IRVING SULMEYER
Counsel of Record
LEWIS RAYMOND LANDAU
SUSAN FRANCES MOLEY
SULMEYER, KUPETZ, BAUMANN & ROTHMAN
A Professional Corporation
300 South Grand Avenue
14th Floor
Los Angeles, California 90071
(213) 626-2311
Attorneys for Petitioner, General Electric Capital Corporation

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